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April 15, 2002

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

William F. Caton, Acting Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W., TW-A325
Washington, D.C. 20554

Re: Standards for granting Retroactive True Ups: Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128; Colorado Payphone Association Petition for Reconsideration re Retroactive Adjustment of Intermediate Period Compensation; Retroactive Adjustment of Interim Compensation

Dear Mr. Caton:

The American Public Communications Council ("APCC") submits the following legal analysis showing that equitable considerations preclude any retroactive refund of compensation payments collected by independent payphone service providers. ("PSPs") from interexchange carriers ("IXCs") during the period from October 7, 1997 to April 21, 1999 ("Intermediate Period").[1]

SUMMARY

As recognized by the D.C. Circuit in *MCI Telecommunications Corp. v. FCC*, 143 F.3d 606 (D.C. Cir. 1998) (which gave rise to the Intermediate Period refund issue by remanding the Commission's $.284 compensation rate), the question whether to order retroactive rate adjustments after a court remand is a question of equity. There is no presumption that a true-up must be held after a court remand.

[1] The question whether to order retroactive refunds for the Intermediate Period is before the Commission in the Colorado Payphone Association's April 21, 1999, petition for reconsideration ("*CPA Petition*") of the *Third Payphone Order. Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, Third Report and Order and Order on Reconsideration of the Second Report and Order*, 14 FCC Rcd 2545 (1999) ("*Third Payphone Order*") *aff'd*, *American Pub. Com. Council v. FCC*, .215 F.3d 51 (D.C. Cir. 2000).

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The Commission *may* order a refund and true-up of compensation payments only if the Commission finds, after balancing the equities, that such retroactive payments and refunds are warranted in the circumstances of this proceeding.

When the standards of equity established by precedent are applied to the circumstances of this case, it is clear that no true-up is warranted, much less required, between independent PSPs and IXCs. First, and of greatest importance, the "unjust enrichment" standard for granting post-remand refunds has not been satisfied. The independent PSPs have earned no excessive profits. In fact, the compensation actually collected by independent PSPs has failed to meet the FCC's own cost-based standard of fair compensation both in the Intermediate Period and in every other compensation period from 1992 through 1999.

Indeed, even if the Commission could possibly find that independent PSPs had gained excessive profits in the Intermediate Period, (and as mentioned above and we demonstrate below, there actually has been a cost recovery shortfall) the Commission must determine whether a refund of Intermediate Period compensation collected by independent PSPs is "equitable in the circumstances" (*Wisconsin Electric Power Co. v. FERC*, 602 F.2d 452, 457 (D.C. Cir. 1979)). In doing so, the Commission must recognize that the relevant circumstances here extend beyond the boundaries of the Intermediate Period. The relevant circumstances include a series of legal errors committed by the Commission in three sequential periods – the Early Period (June 1, 1992 – November 6, 1996), the Interim Period (November 7, 1996 – October 6, 1997), and the Intermediate Period. When all three periods are considered together, it is clear that compensation that PSPs lost due to the FCC's legal errors, and the attendant enrichment of IXCs, both on an individual and collective basis, far outweighs any excess compensation that PSPs could possibly be found to have collected during the Intermediate Period.

By contrast, to award a retroactive refund for the Intermediate Period would provide a windfall for IXCs who have already recovered – and overrecovered – the full amount of the compensation paid to PSPs during that period. A retroactive refund would therefore accord IXCs triple recovery – recovery from end users, who would not get back any of the payphone surcharges they paid, the "free ride" the IXCs experienced by avoiding payment for the majority of dial around calls for a 4 year period,[2] and recovery from PSPs pursuant to the retroactive refund.

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[2] See Letter of April 15, 2002 to William F. Caton, Acting Secretary, FCC, from Albert H. Kramer and Robert F. Aldrich re Early Period (1992-1996) Compensation ("Early Period Ex Parte").

Additionally, a refund of the size contemplated would endanger the economic health of the payphone industry, would create an administrative nightmare for the payphone industry, and would unfairly penalize PSPs even further by forcing them to bear the burden of correcting all errors.

I. REFUNDS OF PAYPHONE COMPENSATION MAY NOT BE AWARDED IF THERE WAS NO UNJUST ENRICHMENT OF PAYPHONE SERVICE PROVIDERS

The refund issue for the Intermediate Period arises from *MCI*, 143 F.3d 606, which remanded (without vacating) the Commission's $.284 rate. That decision expressly recognized that refunds are a form of equitable relief reserved for circumstances where a refund is required to do equity between the parties. Thus, the court, quoting the Commission's own finding, stated that the Commission "may" order refunds "'if the equities so dictate.'" *MCI* at 609, *quoting Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding*, FCC 97-1673 (Aug. 5, 1997). The court plainly did not require the Commission to order a refund in the event that the Commission, on remand, established a rate of less than $.284. The court did not even create a presumption of a refund.

The court of appeals' use of "may" rather than "shall" was no accident. In *Consumer Federation of America v. Federal Power Commission*, 515 F.2d 347 (D.C. Cir. 1975), *cert. denied*, 423 U.S. 906 (1975), the court of appeals, in reversing a Federal Power Commission rate order on the merits,[3] stated:

> We express no opinion on the refund issue, beyond saying that, in our view, it involves complex and difficult questions which must be presented to and addressed by the Commission in the first instance. In matters of prospective and retroactive effect, there are large questions of equity and public interest – both for agencies and for courts . . . . Whether and how to exercise an authority to order refunds requires the development of factual matters not presently in the record as well as a broad and penetrating analysis of "the factors pro and con a refund,

[3] In an earlier phase of the proceeding, the Supreme Court had vacated a stay, granted by the Court of Appeals, of the Federal Power Commission ("FPC") rate order under review. In overturning the stay, the Supreme Court had relied on a similar representation by the Solicitor General that the FPC "would have full authority to require refunds of any [excessive] rates collected by a natural gas company." *Id.* at 359.

> and its amount or extent, in arriving at an equitable conclusion."

Id. at 359, *quoting Public Service Commission of the State of New York v. Federal Power Commission*, 329 F.2d 242, (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964). The *MCI* court followed these precedents and similarly refrained from tying the FCC's hands in advance of a "broad and penetrating analysis of 'the factors pro and con a refund'" in this proceeding. Such an analysis, however, must be completed before deciding whether to award refunds.

In general, the standard governing agency decisions to award rate refunds is an equitable one, in which the agency must strike a "balance . . . between the comparative benefits and losses, often termed 'equitable considerations.'" *Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1047 (D.C. Cir. 1981), *quoting Public Service Commission v. FPC*, 329 F.2d 242, 250 (D.C. Cir.), *cert. denied*, 377 U.S. 963 (1964). *See also Wisconsin Electric Power*, 602 F.2d at 457 (refund decision must be "equitable in the circumstances"); *Koch Gateway Pipeline Co. v. FERC*, 136 F.3d 810, 817 (D.C. Cir. 1998) (holding that a refund must be equitable under the circumstances). Applying this standard, reviewing courts have recognized in numerous cases that the particular circumstances involved do not justify the grant of refunds.[4]

Unless an award of refunds is compelled by the agency's governing statute, courts of appeals generally have not imposed a presumption in favor of refunds. *See Towns of Concord,* 955 F.2d at 75 (D.C. Cir. 1992)("[A]bsent some conflict with the explicit requirements or core purposes of a statute, we have refused to constrain agency discretion by imposing a presumption in favor of refunds").

Furthermore, a refund presumption is particularly disfavored where an agency has affirmatively approved or prescribed a rate but the rate order has been remanded by the court of appeals. The principle applicable to such refund decisions was enunciated by the Supreme Court in *Atlantic Coast Line R.R. v. Florida*, 295 U.S. 301 (1935). Because a refund in these circumstances is akin to a restitution action, "a remedy which is equitable in origin and function," to justify a refund it is necessary to establish:

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[4] *Exxon Co. v. FERC*, 182 F.3d 30, 49 (D.C. Cir. 1999) ("'Refunds are not mandatory; the Commission has the discretion to decide whether a refund is warranted in light of the interests of the customer and the utility.'") (*quoting Second Taxing Dist. Of the City of Norwalk v. FERC*, 683 F.2d 477, 490 (D.C. Cir. 1982)); *Koch*; *Towns of Concord, Norwood, and Wellesley, Mass. v. FERC*, 955 F.2d 67 (D.C. Cir. 1992); *Public Service Commission of West Virginia v. Economic Regulatory Administration*, 777 F.2d 31, 35 (D.C. Cir. 1985); *Moss v. Civil Aeronautics Board*, 521 F. 2d 298 (D.C. Cir. 1975), *cert. denied*, 424 U.S. 966 (1976).

> that the money was received in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it.

Id. at 309. The courts have continued to apply the *Atlantic Coast* standard, imposing no presumption that refunds must be awarded after a court remand. *See, e.g., West Virginia*, 777 F.2d at 35 (declining to apply a "strong, albeit rebuttable, presumption in favor of refunds"). In remand cases, unlike the typical refund situation, the rates normally have been "charged by the carriers in reasonable reliance on the [agency's] explicit approval of them." *Moss*, 521 F.2d at 314 (D.C. Cir. 1975). Accordingly, "the consequences of [the agency's] mistake should not be visited upon the carriers," especially in the absence of "any actual unjust enrichment." *Id.* at 315.

There is no bright-line test to determine whether a refund should be awarded. In the absence of unjust enrichment, agencies have been held to have abused their discretion by ordering refunds. *See, e.g., Koch*, 136 F.3d at 817 (holding that FERC should not have ordered a pipeline to pay its customers a refund since the pipeline did not receive a windfall). Even the presence of unjust enrichment, however, does not dictate that refunds be awarded. In evaluating the appropriateness of a refund, the Commission is required to look at the particular facts of the case to determine what is fair. An agency's decision must represent a "reasonable accommodation of the relevant factors" and the court must be satisfied that the remedy is "equitable under the circumstances." *Koch* at 816 (*quoting Laclede Gas Co. v. FERC*, 997 F.2d 936, 944 (D.C. Cir. 1993)). In all cases, an agency must carefully consider equitable factors prior to ordering a refund.

As the legal recipients of compensation payments at the rate prescribed by the Commission, the PSPs in this proceeding stand in the same shoes as the carriers in the cases discussed above, and have the same equitable rights to retain payments legally collected under prescribed rates, unless they are shown to have been unjustly enriched by those compensation payments.

II. THE EQUITIES IN THIS CASE PRECLUDE ANY AWARD OF REFUNDS FOR THE INTERMEDIATE PERIOD

Applying the equitable principles of these cases to the situation in this proceeding leaves no doubt that the Commission cannot fairly require independent PSPs to refund compensation that they legally collected from IXCs during the Intermediate Period.

In *Moss*, the D.C. Circuit federal court of appeals discussed in exhaustive detail the equitable standards and considerations applicable to a request for post-remand refunds of airline passenger fares involving hundreds of millions of dollars.[5] The court previously had invalidated certain fares that were determined in violation of statutory procedures and ratemaking criteria. Petitioners sought refunds of the difference between the unlawfully adopted rates and the rates that would have resulted from retroactive application of the ratemaking standards subsequently adopted.

Stating that "the Board correctly focused on the equity of restitution and not just the reasonableness of past rates" (*Id.*, 521 F.2d at 308), the Court noted that a variety of equitable considerations could justify denial of refunds even where fares exceeded what was just and reasonable. Such considerations included: (1) the absence of actual profits; (2) the impossibility of reimbursing those who actually paid the illegal rates; and (3) the adverse impact of a refund on the health of the industry involved, especially if the industry has experienced a "ruinous decline" in traffic volumes. *Id.*

These factors are all present and apply with even greater force to the instant matter of payphone compensation refunds. Unlike the rate in *Moss*, which was prescribed in violation of statutory procedures and criteria, in this case the $.284 rate at issue was legally prescribed under the statute but was remanded for a clearer explanation of the ratemaking rationale. Like *Moss*, the equitable factors relevant to this case clearly compel the conclusion that no refund is warranted for compensation legally collected by PSPs during the Intermediate Period.

A. Absence of Excessive Profits

One of the key factors considered in *Moss* and other cases in deciding whether to grant post-remand refunds is whether the service providers *actually earned* excessive profits during the relevant period. In *Moss* the court stressed that "during the period in which the October 1, 1969, rates were charged, the airlines did not in fact earn excessive profits from their passenger operations." *Moss* at 302. Similarly, the PSPs have not earned "excessive profits" from the $.284 rate charged in the Intermediate Period.

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[5] Just one relatively minor aspect of the invalidated rate increase, which allowed the airlines to round up fares to the nearest dollar, yielded some $50 million in additional revenue, which is more than the total amount of approximately $35 million at stake for the independent PSPs for the Intermediate Period.

1. IPSPs Did Not Recover, on Average, Even the Minimum Recovery Found Necessary by the Commission for a Marginal Payphone, Much Less Realize Any Unjust Enrichment

As APCC has shown, even at the $.284 rate, independent PSPs did not, in fact, earn the amount of dial-around compensation revenues that the FCC found would be necessary to recover the costs of payphones installed at marginal locations. *See* Letter from Albert H. Kramer to Dorothy Attwood, March 26, 2001, at 5 ("*APCC March 26, 2001 Ex Parte*"), Attachment 1 hereto (showing that independent PSPs' marginal payphones collected an estimated $27.55 per payphone per month in 1998, more than six dollars below the level of compensation required for marginal payphones to break even under the Commission's own cost analysis supporting the $.24 rate).

In evaluating whether excessive profits were earned, the court of appeals in *Moss* recognized (as did the Board) that ratemaking standards applied to the prospective determination of "just and reasonable rates" do not automatically apply to retroactive determinations in which the standard is unjust enrichment. *Id.* at 308. In *Moss*, for example, the Board found that the actual "load factors" (estimated percentage of airplane seats filled) experienced during the period for which refunds were claimed were substantially lower than the load factors adopted prospectively. *Id.* at 309. The Board also declined to apply retroactively its prospective ratemaking policy that disallowed any allowance for dilution of revenues due to discount fares. The Court agreed that it would be inequitable to apply retroactively a policy designed to influence prospective behavior (by discouraging discount fares), especially "when inadequate profits were made by the carriers even under the constraints then applicable." *Id.* at 312.

Similarly, with respect to cost recovery the PSPs have experienced problems analogous to those that prevented the airlines from earning a reasonable rate of return. Just as the airlines' traffic volumes were lower than the prospective rates assumed, APCC has shown that the actual call volumes per payphone for which compensation was collected during the Intermediate Period are far lower than the estimated call volumes on which the $.238 rate was based. Moreover, these lower collections resulted primarily from PSPs inability to identify and effectively collect compensation from resellers.[6] In the *Third Payphone Order* the Commission prospectively excluded any allowance for uncollectable compensation in its cost-based rate of $.24 per call, because at that time there was insufficient experience

[6] Another factor in the low level of compensated call volumes, which was equally beyond PSPs' control, was the failure of LECs and IXCs to timely implement the payphone coding digit identifiers ordered by the Commission.

with uncollectables in a per-call system. At the same time, however, the Commission acknowledged that there could be a defect in the compensation scheme causing massive shortfalls in collections. Prospectively, the Commission found that uncollectables "would be significantly reduced" if the Commission acted favorably on the pending issue of who pays for reseller calls.[7] But the issue of how to address uncollected compensation retroactively was left open. Indeed, in the *Third Payphone Order* the Commission expressly recognized that equity required it to consider uncollectables in its planned retroactive true-up for the Interim Period. *Id.*, ¶ 162.

Consideration of uncollectables is equally relevant to the equity of requiring refunds for the Intermediate Period. Whatever the merits of disallowing uncollectables on a prospective basis, it is clearly inappropriate to apply the same rate retroactively in light of the current record. Remedying the insufficiency of evidence that the Commission was concerned about in the *Third Payphone Order,* APCC has demonstrated that massive amounts of uncollected compensation for the relevant period have resulted from now-recognized defects in the compensation scheme. *See APCC March 26, 2001 Ex Parte* at 5-6, Attachment 1, hereto.

2. Any Overcompensation of Independent PSPs Is Far Outweighed by the Undercompensation of Independent PSPs in the Early Period

Even if the Commission were to find that independent PSP revenues exceeded costs during the Intermediate Period, which, as we have shown, they did not, the determination of whether the Commission's error necessitates corrective action to redress "unjust enrichment" must consider whether any excess profits of independent PSPs in the Intermediate Period were offset by the massive undercompensation of independent PSPs in related periods as a result of *other* FCC errors of law. The record shows that independent PSPs were grossly undercompensated in the Early Period (June 1, 1992 – November 6, 1996).[8]

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[7] *Id.*, ¶ 162. The Commission did, subsequent to the Intermediate Period in question here, act prospectively to resolve the problem of collecting from resellers, by shifting payment responsibility to the first facilities-based IXC. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Second Order on Reconsideration*, 16 FCC Rcd 8098 (2001) *petition for review pending, Sprint v. FCC*, (D.C. Cir. No. 01-1266, filed June 12, 2001). Thus, the Commission's prospective "fix" came too late to assist PSPs during the Intermediate Period..

[8] Independent PSPs also were undercompensated for the Interim Period (November 7, 1996 – October 6, 1997). See Early Period Ex Parte, Attachment 2.

While service providers may not be entitled as a matter of *law* to recoup past losses in *prospective* rates, the question of *equity* posed by *retroactive* application of post-remand rates presents different considerations. In the real world, a firm's profitability and economic health depends on its performance over time, not on whether profits were earned in each period taken in isolation. APCC has shown that due to additional errors of law on the part of the FCC, PSPs did not come close to collecting the FCC-defined cost-based compensation in the Early Period. *Id.* If the Commission intends to take retroactive action to correct mistakes, it must consider globally all its mistakes affecting related periods of payphone compensation. The massive undercompensation suffered by PSPs in these periods must be offset against any excess profits attributed to independent PSPs.

In sum, ordering independent PSPs to refund IXCs compensation for the Intermediate Period would be inconsistent with case precedent and with the governing statutory provision. As the court observed in the decision that gave rise to this remand proceeding, Section 276(b)(1) of the Act provides the FCC with "the authority to order refunds *where overcompensation has occurred,*" *i.e.*, "where doing so is necessary to ensure fair compensation." *MCI*, 143 F.3d at 609. As discussed above, independent PSPs were in fact grossly undercompensated in the Early, Interim, and Intermediate Periods. Thus, to order independent PSPs to refund IXCs would be inconsistent with Section 276(b)(1) of the Act which requires the Commission to ensure fair compensation to payphone providers. 47 U.S.C. § 276(b)(1).

B. The IXCs Have Already Recovered Their Payments – The End Users That Actually Paid the Higher Rates Will Not Receive Refunds

Another factor considered in *Moss* was that "it may be impossible to reimburse those who actually paid the illegal rates." *Id.*, 521 F.2d at 308. Here, it is similarly impossible to reimburse the ultimate ratepayers. IXCs have already recovered the Intermediate Period compensation from their customers, and would be the recipients of a massive windfall if they were paid a refund by independent PSPs. *See* CPA Petition, Exhibit 2.[9] There is no reason to believe that the IXCs will pass a refund on to their customers – and there is certainly no way to provide a refund to those customers who actually paid for the payphone calls made during the Intermediate Period.

[9] Exhibit 2 of the CPA Petition and relevant text from the CPA Petition are appended as Attachment 2 hereto for the convenience of the Commission.

Moreover, requiring independent PSPs to refund IXCs would unjustly enrich IXCs even if one assumed that IXCs had paid independent PSPs an amount greater than independent PSPs' cost of originating dial around calls. This is because IXCs pass on the cost of dial around compensation to their customers. Thus, further recovery would mean that IXCs would be recovering their costs more than three times: (1) in the initial recovery from end users, who would not get back any of the payphone surcharges they paid, (2) in various payphone-related cost savings, including the "free ride" the IXCs experienced by avoiding payment for the majority of dial around calls for a 4 year period,[10] and (3) in the recovery from PSPs pursuant to the retroactive refund.[11]

IXCs have passed on or otherwise recovered their cost of dial around compensation in several ways. First, IXCs assess millions of dollars in surcharges on payphone calls. In the Intermediate Period, some major IXCs assessed surcharges of up to 35 cents per call. *See* CPA Petition, Exhibit 2 at 1, Attachment 2, hereto (attachment to letter from Marie Breslin to Magalie Roman Salas, March 11, 1998). Prepaid card providers frequently assessed even higher surcharges. Thus, the amount of the surcharges exceeded the $.24 compensation rate. In addition to the surcharges, IXCs raised their rates for subscriber 800, business long distance, and calling card calls, explicitly to compensate PSPs. In 1997, AT&T alone generated some $640 million dollars from its rate increases. *Id.*

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[10] See Letter of April 15, 2002 to William F. Caton, Acting Secretary, FCC, from Albert H. Kramer and Robert F. Aldrich re Early Period (1992-1996) Compensation ("Early Period Ex Parte").

[11] The Commission may be concerned about whether individual IXCs may have overcompensated independent PSPs in the Intermediate Period, even though the total compensation collected in that period did not unjustly enrich PSPs. In light of the IXCs' demonstrated recovery and over-recovery of their compensation payments, the Commission need not be troubled by such overpayment concerns. Further, the Commission is not required to balance the books of every IXC who paid compensation in the Intermediate Period. The Commission is only required to address equity for IXCs collectively. In *Moss* the court did not examine whether individual passengers paid unreasonable fares for their flights, and the Commission likewise is not compelled to address whether each individual IXC overcompensated PSPs. In other words, an analysis at the industry level of whether a refund is appropriate is sufficient.

Notwithstanding these considerations, to address any lingering concerns about overpayment, APCC intends shortly to submit data that it believes will show that, when all relevant compensation periods are taken into account, each of the major IXCs paid less than its share of the compensation needed for full cost recovery by independent PSPs.

At the same time that IXCs were overcompensated by their customers for their dial-around payments through the surcharges and rate increases, IXCs saved $250 million per year from the elimination of interstate subsidies for payphone services provided by local phone companies. *Id.* Significant additional subsidies were also terminated at the state level. *See* CPA Petition (Attachment 2 hereto), Exhibit 3 at 17 (attachment to letter from Albert H. Kramer to Magalie Roman Salas, March 16, 1998). The IXCs have also saved a significant amount of money from the reduction in commission payments to PSPs due to the shift away from commissionable 0+ calls. In 1997 alone, IXCs saved some $370 million from this shift. *See* CPA Petition (Attachment 2, hereto), Exhibit 2 at 1 (attachment to RBOC Coalition *ex parte* letter from Marie Breslin to Magalie Roman Salas (March 11, 1998)).

Accordingly, not only have IXCs over recovered for their dial around costs from their customers through surcharges and rate increases, IXCs have also failed to pass on to their payphone customers any portion of their cost savings from the payphone-related reduction in access charges and the reduction in commissionable 0+ calls. In light of this, requiring PSPs to pay retroactive compensation to IXCs would provide IXCs with a significant windfall. There is no reason to believe that IXCs would pass through to payphone callers the refunds awarded by the Commission, and in any event, it would be "impossible to reimburse those who actually paid" the payphone surcharges in the Intermediate Period. *Moss*, 521 F.2d at 308.

C. The Payphone Industry Would Be Economically Endangered By Mass Refunds

Another factor considered in *Moss* was the need to preserve the health of the airline industry, especially if that industry has already suffered a "ruinous decline" in traffic volume:

> Even if excessive profits were made in a given period, there may be inequity in trying to recover them. . . . The bite which is effectively taken from future earnings by a recovery fund may in turn impair the health of the industry, to the disadvantage of the fare-payers themselves. . . . The excessive profits sought to be recovered were not in fact earned but must be hypothesized by a recomputation of costs and revenues. A substantial fare-payer recovery on this theory would in practical effect mean that an airline industry which had performed badly in the past (from the investors point of view) would be all the more likely to perform badly in the future. The equitable aspects of

> refunding past rates are as inextricably entwined with the Board's normal regulatory responsibility, as such refunds may substantially affect the future rates, performance, and health of the industry.

Id. at 308.

Just as the statutory objectives governing the Civil Aeronautics Board guided the analysis of equities in *Moss*, the Commission's statutory responsibility to "promote . . . widespread deployment of payphones to the benefit of the general public" must guide its equitable determinations here. 47 U.S.C. § 276(b). The Commission's foremost duty is to "ensure that payphone service providers are fairly compensated" in order that payphone deployment may be promoted by federal compensation policy. *Id.*, § 276(b)(1)(A). At a minimum, the Commission must "do no harm": its exercise of discretion regarding compensation refunds must not suppress payphone deployment or impair the health and performance of the payphone industry.

Today, the danger to payphone deployment that would result from a refund of Intermediate Period compensation is at least as serious as the danger to the airline industry with which the court was concerned in *Moss*. As the Commission is well aware, the sharp and steady annual increases in wireless phone use have caused a debilitating decline in payphone call volumes and payphone industry profits. As FCC statistics show, the result has been a significant decline in payphone deployment since 1999. *See* FCC Common Carrier Bureau, Industry Analysis Division, *Trends in Telephone Service*, August 2001, Table 8.5 (showing that the total number of payphones in the United States declined from 2,121,526 in March 1999 to 1,919,640 in March 2001). In community after community, these statistics translate into the removal of payphones from locations where there is still a significant need for service. *See* Attachment 3. And as the events of September 11, 2001 demonstrated, the need for payphones is greatest in emergencies. At such times it is critical for payphones to be available to provide a lifeline for distressed citizens.

The contemplated refund of Intermediate Period compensation would total about $33 million for PSPs for whom APCC collects payphone compensation – which is roughly equal to those PSPs' total compensation payment for three months. There can be little doubt that a refund of a full quarter's dial-around compensation would significantly "impair the health of the industry" and the continuing deployment of payphones to meet the needs of the public.

D. Refunds Will Cause an Administrative Nightmare and Unfairly Force PSPs to Bear the Burden of Errors

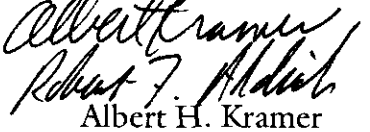
Finally, the Commission should not order a true-up for independent PSPs given the administrative complexity of implementing such an order and given that the nature of the compensation process will force independent PSPs to bear the burden of correcting errors, absent preventive Commission action. There are more than a hundred IXCs and thousands of independent PSPs involved in Intermediate Period compensation; an unknown but substantial percentage of these IXCs and PSPs are no longer operating. Furthermore, with payphones continually changing hands, merely determining who currently has responsibility to provide each refund would cause an administrative nightmare.

Due to the nature of the compensation process, these problems will penalize PSPs far more than IXCs. In the compensation process, IXCs hold the money. Absent FCC intervention, therefore, any IXC that thinks a given PSP is responsible for a given refund will simply deduct that amount from the PSP's future compensation payments. The PSP's only recourse is litigation. PSPs have absolutely no leverage in this process. They cannot even cut off service to IXCs that refuse to pay, because Section 226 prohibits blocking of access code calls.

CONCLUSION

In summary, the Commission may not conclude that refunds of intermediate compensation are appropriate simply because the current rate is lower than the rate established in the *Second Report and Order*. The Commission must weigh all relevant equitable considerations to reach a decision that is fair under the circumstances. Here, fairness precludes requiring independent PSPs to pay a refund to IXCs for the Intermediate Period.

Sincerely,



Albert H. Kramer
Robert F. Aldrich

ATTACHMENT 1

STAMP AND RETURN

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March 26, 2001

Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: CC Docket No. 96-128; Retroactive Adjustment of Interim Compensation

Dear Ms. Salas:

Enclosed for filing with the Federal Communications Commission is a copy of an Ex Parte Presentation in CC Docket No. 96-128.

If you have any questions about this matter, please contact the undersigned.

Sincerely,

Albert H. Kramer
Robert F. Aldrich

Enclosure
cc: Dorothy Attwood
Jared Carlson
Jane Jackson
Lenworth Smith

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March 26, 2001

Ms. Dorothy Attwood, Chief
Common Carrier Bureau
Federal Communications Commission
445 12th Street, S.W., Room 5-C345
Washington, D.C. 20554

Re: **CC Docket No. 96-128; Retroactive Adjustment of Interim Compensation**

Dear Ms. Attwood:

This letter submits, on behalf of the American Public Communications Council ("APCC"), additional information that is relevant to two pending matters: (1) the Regional Bell Operating Companies' ("RBOCs") proposal (filed August 8, 2000) to use the current $.24 dial-around compensation rate and 1998 call counts of actually compensated calls to retroactively adjust the compensation paid to all payphone service providers ("PSPs"), independent PSPs and local exchange carrier ("LEC") PSPs alike, during the period from November 6, 1996 to October 6, 1997 (the "Interim Period");[1] and (2) the Colorado Payphone Association's pending Petition for Partial Reconsideration (filed April 21, 1999) of the Commission's *Third Report and Order* [2]decision to apply the $.24 rate retroactively to the period from October 7, 1997 to April 21, 1999 (the "Second Report and Order Period").[3]

Information recently compiled by APCC shows that the volume of *actually* compensated calls from the *average independent* payphone in 1998 was approximately 109 calls per payphone per month. However, the current $.24 (or, for retroactivity purposes,

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[1] During the Interim Period, flat-rate compensation totaling $45.85 per payphone per month, based on the Commission's initially prescribed rate of $.35 per call, was initially in effect but was interrupted when the court of appeals vacated the $.35 rate.

[2] *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Third Report and Order, and Order on Reconsideration of the Second Report and Order*, 14 FCC Rcd 2545 (1999).

[3] During the Second Report and Order Period, the rate of $.284 per call, prescribed in the *Second Report and Order*, was in effect. After a court remand of that rate, the Commission prescribed a new rate of $.24 per call.

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$.238) compensation rate was set based on call volume at a *marginal* payphone of 142 calls per payphone per month. Therefore, it would be clearly inequitable and would grossly undercompensate independent PSPs for the Commission to retroactively adjust compensation payments based on the current $.238 rate and the actual volume of calls in 1998.

Background

As explained in APCC's October 20, 2000 comments on the RBOC proposal, the Commission cannot simply order retroactive compensation adjustments as a matter of course. Retroactive rate adjustments may be ordered after a court remand only if the equities so require. *Towns of Concord v. FERC*, 955 F.2d 67, 75-76 (D.C. Cir. 1991). The Commission has not yet made a final ruling on *whether* to order retroactive adjustments for the Interim Period. Comments of APCC, filed October 20, 2000, at 5.

Moreover, the Commission must not treat retroactive adjustment of the Interim Period compensation in isolation from the closely related issue of retroactive adjustments of the Second Report and Order Period compensation. The Commission has already linked the *implementation* of retroactive compensation adjustments for these two periods, stating that they would occur simultaneously. *Third Report and Order*, 14 FCC Rcd at 2636. There are other obvious linkages, as well. The Commission must make consistent decisions on (1) whether the equities warrant retroactive adjustments for the two periods and (2) the methodologies to be used for determining the amount of any adjustments.

For both periods, the issue of whether and how to make retroactive adjustments remains open. As to the Interim Period, as noted above, no final decision has been made. As to the Second Report and Order Period, while the Commission did order retroactive application of the $.24 rate to that period, it failed to explain its ruling, and did not evaluate the equities prior to the ruling. Still pending is the Colorado Payphone Association's Petition for Partial Reconsideration of the *Third Report and Order*, filed April 21, 1999, which requests the Commission to reconsider, in light of the equities, its unexplained decision to require retroactive adjustments for independent PSPs for the Second Report and Order Period.[4]

Accordingly, the questions of whether, and if so, on what basis, to order retroactive compensation adjustments for the Interim Period and the Second Report and Order Period remain to be addressed. The Commission must address these questions together, in a consistent and equitable fashion. Therefore, prior to deciding whether to adopt the RBOCs' specific implementation proposal for the Interim Period, the Commission must decide the prior question whether retroactive application of the current

[4] The Colorado Payphone Association's petition also requests reconsideration of the $.24 per call rate set in the *Third Report and Order*, on the grounds that the FCC made several mistakes in analyzing PSPs' costs. For purposes of this letter, we assume that the Commission denies reconsideration of the $.24 rate.

$.24 per call rate to prior compensation periods (*i.e.*, the Interim Period *and* the Second Report and Order Period) is even warranted, as a matter of equity.

In its comments and reply comments on the RBOC proposal, APCC showed that, at least for independent PSPs, it would not be equitable to apply the $.24 rate retroactively to 1998 call volumes, for purposes of either Interim Period or Second Report and Order Period compensation.[5] APCC argued that, at least with respect to the compensation received by independent PSPs, the equitable solution -- one that will also avoid imposing huge administrative burdens on the parties and the Commission -- is to rule that there will be no compensation adjustments for *either* the Interim Period *or* the Second Report and Order Period. The additional information submitted herewith further confirms the validity of APCC's position.

Discussion

In its comments on the RBOC proposal, APCC explained that utilizing actual 1998 compensation payments as the basis for 1996-97 Interim Period adjustments would be patently inequitable because independent PSPs were uncompensated in 1998 for a huge volume of compensable dial-around calls. First, LECs and interexchange carriers ("IXCs") spent the Interim Period – during which LECs and IXCs were supposed to implement the system for call tracking – bickering over how to implement the Commission's call tracking requirement. The Commission ultimately ruled that LECs must implement FLEX ANI, but not before the Commission had to waive the October 7, 1997 implementation deadline. There were then massive problems experienced by independent PSPs with (1) LEC implementation, and IXC processing, of FLEX ANI codes that are supposed to "tag" payphone calls so that IXCs can track and pay for the calls.[6] Second, PSPs experienced massive problems identifying and collecting compensation from "switch-based" resellers who are supposed to be responsible for paying compensation under the FCC rules.

Since filing its comments on the RBOC proposal, APCC has compiled more complete information on the average volume of *actually compensated calls*, per payphone per month, for independent PSPs. For 1998, payphones for whom APCC's compensation clearinghouse affiliate collects compensation, representing close to three quarters of all independent payphones, have been paid dial-around compensation for an average of 109 calls per month. As discussed below, that number is far below the call volume that the Commission assumed was necessary in order to recover the costs allocated to dial-around calls. Accordingly, APCC's payment data confirms that applying the current $.24 rate to 1998 call volumes, so as to retroactively adjust the compensation received for the Interim

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[5] The equities may differ between ILEC PSPs and independent PSPs. But independent PSPs have many equities in their favor. *See*, e.g., note 9 below.

[6] The LEC PSPs did not experience the same problems because most of their payphone lines transmitted hard coded payphone identifiers as part of the legacy of past discrimination against independent PSPs.

Period and for the Second Report and Order period – would result in systematic undercompensation of independent PSPs.

The significance of this shortfall is easily demonstrated. The Commission set the $.24 rate in the *Third Report and Order* based on its analysis of the per-call cost of maintaining a payphone in a "marginal location." The Commission sought to "ensure that the current number of payphones is maintained," and concluded that "the default per-call compensation amount we establish should ensure that each call at a marginal payphone location recovers the marginal cost of that call plus a proportionate share of the joint and common costs of providing the payphone." *Third Report and Order* at 2571. The Commission determined that "establishing a compensation amount that allows a PSP to recover its costs will promote the continued existence of the vast majority of payphones presently deployed, thereby satisfying what we consider to be Congress's primary directive that we ensure the widespread deployment of payphones." *Id.* at 2579.

The Commission found that the joint and common costs of a payphone at a marginal location totaled $101.29, and that an average of 439 calls (of all types) per phone per month are made from payphones at marginal locations. Dividing $101.29 by 439 yielded per call joint and common costs of $.231. Adding $.009 per call of costs specific to dial-around calls yielded a total of $.24 per call – adjusted to $.238 for purposes of retroactive compensation. *Third Report and Order* at 2632.[7]

The Commission's determination that a $.24 (or $.238) rate would ensure recovery of the costs of a marginal payphone was thus based on its determination that marginal payphones have 439 calls per payphone per month. *Third Report and Order* at 2612. Of these 439 calls, the Commission found that an average of 142 calls were dial-around calls (the rest are primarily coin calls). Id. at 2614, n. 302. The Commission thus expected that, to enable a payphone in a marginal payphone location to recoup its monthly joint and common costs, the payphone would generate an average of 142 dial-around calls, producing dial-around revenues of 142 x $.238, or $33.80 per month in dial-around compensation. The Commission reasoned that if PSPs operating payphones in marginal locations were compensated for all 142 of the dial around calls at a rate of $.238, then they would be able to recover their monthly costs, thereby ensuring "that the current number of payphones is maintained."

As the attached information on compensation payments makes clear, however, payphones at marginal locations have actually received compensation on far fewer than 142 calls per month. As noted above, the actual dial-around compensation payments in 1998

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[7] For purposes of retroactive application, however, the Commission stated that the rate would be $.238, because $.002, representing Flex ANI costs, would only be incurred for a three year period, on average, and therefore would only be recoverable prospectively, for three years beginning on the effective date of the order. *Third Report and Order* at 2635.

to the *average* APCC client payphone compensated the PSP for only about 115 calls per payphone per month.

Determining the impact of this shortfall on retroactive compensation adjustments is a matter of simple arithmetic. APCC's data on actually compensated calls relates to the *average independent payphone, not marginal payphones*; therefore, the proper comparison is between the 109 *compensated* calls at the *average* payphone and the number of *compensable* calls at an *average* payphone. The Commission found that *average* RBOC payphones generated 155 compensable calls per month (*id.* at 2614), which confirms APCC's survey-based estimate that the *average* independent payphone had 159 compensable dial-around calls per month. Thus, it is reasonable to conclude that in 1998 independent PSPs were compensated, on average, for only 109 out of 159 compensable calls per month, or 68.6% of compensable calls.

To translate this shortfall into the terms of the Commission's marginal payphone policy is also a simple matter. Given that the *average* independent payphone was paid on only 68.6% of compensable calls per payphone per month, it is reasonable to infer that a *marginal payphone* was paid on a comparable percentage of calls. Applying this percentage to the monthly call volume of 142 calls for marginal payphones yields a paid call volume for marginal payphones of about 97 calls per payphone per month, for total compensation of $27.55 per payphone per month (at the 1998 rate of $.284 per call). This is substantially lower than the $33.80 per month required by the Commission's analysis in the *Third Report and Order*. If the current $.238 rate is applied retroactively to 1998 call volumes, as proposed, the undercompensation of PSPs would become even worse (97 x $.238 = $23.09 per payphone per month).

To achieve the $33.80 per payphone per month cost recovery intended in the *Third Report and Order*, adjusted compensation for the Interim Period and Second Report and Order Period, if based on actual call volumes, would have to *exceed* substantially the *Second Report and Order* rate of $.284 per call ($33.80/97 = $.348).

Under these conditions, a retroactive adjustment based on the current rate of $.238 per call would be grossly inequitable, particularly because the causes of the shortfall in compensated calls are beyond independent PSPs' control. As noted in APCC's comments, the difference between actual and expected compensation payments results largely from massive problems experienced by PSPs with (1) LEC implementation, and IXC processing, of FLEX ANI codes that are supposed to "tag" payphone calls so that IXCs can track and pay for the calls; and (2) identifying and collecting compensation from "switch-based" resellers who are supposed to be responsible for paying compensation under the FCC rules. These problems have been amply documented to the Commission. Indeed, in the *Third Report and Order*, the Commission specifically acknowledged the reseller issue in explaining its decision *not* to include in the compensation rate an allowance for uncollectables, and stated: "It appears that if we were to grant such a petition, uncollectibles would be significantly reduced." *Id.* at 2619. The Commission also recognized that uncollectables are directly relevant to the issue of retroactive compensation:

> We note that, in a forthcoming order, we will determine the amount that IXCs owe PSPs for the period before October 7, 1997 and the way in which IXCs may recover overpayments that result from the default compensation amount established herein. If a petition for clarification is resolved prior to the adoption of our order addressing IXCs payments prior to October, 1997, we may visit the issue of uncollectibles in that order.

Id.[8]

Under the circumstances, the Commission must find that applying the $.238 rate to the Second R&O Period, or to the Interim Period based on Second Report and Order Period call counts, would disserve the paramount Congressional objective of sustaining widespread payphone deployment, because PSPs, who only received compensation for 68.6% of the compensable calls they handled, would ultimately receive on average $23.09 per marginal payphone per month, rather than the $33.80 the Commission determined was necessary for PSPs to satisfy their monthly costs.

Therefore, the Commission must abandon the attempt to make retroactive compensation adjustments, unless it is prepared to utilize a retroactive compensation rate exceeding $.35 per call.

APCC stresses that it is addressing only the issue of retroactive adjustment of independent PSPs' compensation for the Interim Period and the Second Report and Order Period. APCC recognizes that the RBOCs have taken a different position with respect to retroactive compensation. It would be both feasible and reasonable for the Commission to issue separate rulings with respect to independent payphones and ILEC payphones, in the

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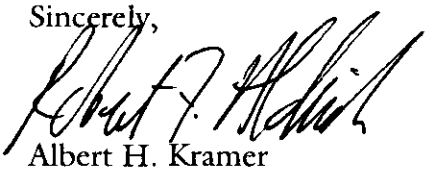
[8] Since issuing the *Third Report and Order*, the Commission has received further evidence that uncollectables are indeed massive. RBOC/GTE/SNET Coalition Petition for Clarification, NSD File No. L-99-34, filed February 26, 1999, at 2-3. RBOC/GTE/SNET Coalition Reply Comments, filed June 1, 1999, at 5-6. Letter to Magalie Roman Salas from Robert F. Aldrich, July 28, 2000.

event that the Commission decides that the equities warrant retroactive adjustment of the compensation received for ILEC payphones.[9]

Sincerely,



Albert H. Kramer
Robert F. Aldrich

[9] For example, independent PSPs went uncompensated for subscriber 800 calls (the bulk of dial-around calls) for four years, due to the Commission's erroneous interpretation of the prior payphone compensation provision, Section 226(e)(2) of the Act. *See Florida Public Telecommunication Ass'n v. FCC*, 54 F.3d 857 (D.C. Civ. 1995). During that same period, LECs fully recovered their payphone costs because their payphones were part of the regulated rate base.

APCCS 1998 Dial Around Compensation Breakdown

Year	Qtr	Unique Submitted ANIs	Collections Per ANI Per Month	Compen-sated Calls Per ANI Per Month
1998	1	369,854	29	101
1998	2	389,149	33	115
1998	3	394,571	33	115
1998	4	373,135	30	104
1998	All	1,526,709	31	109

ATTACHMENT 2

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996	)	CC Docket No. 96-128

PETITION OF THE COLORADO PAYPHONE ASSOCIATION FOR PARTIAL RECONSIDERATION

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